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JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

No. 225

LEWIN WETHERED, TRUSTEE OF THE ESTATE OF JOHN B. GAITHER, JR., INC., BANKRUPT,
Petitioner,

v.

ALBAN TRACTOR COMPANY, INC., HERBERT L. WYNNE, TRUSTEE, AND PLAZA CORPORATION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF MARYLAND

BRIEF OF ALBAN TRACTOR COMPANY, INC. AND HERBERT L. WYNNE, TRUSTEE (TWO OF THE RESPONDENTS HEREIN) IN OPPOSITION

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JURISDICTION

The Trustee in Bankruptcy seeks the issuance of a Writ of Certiorari on the ground that the Court of Appeals of Maryland has decided Federal Questions of Substance not heretofore determined by this Court (Petition — 6); concluding (8*) with the suggestion that the decision turned

* Page references, unless otherwise noted, are to the Petition for a Writ.

upon Federal Questions of Substance "not yet * * * reached in this Court's chain of decision construing" certain tax principles.

Doubtless it is noteworthy that the Treasury Department, though its representatives, in the presence of Government counsel, testified in the trial Court and were aware of the decisions, does not join with the Trustee in Bankruptcy in advancing the contention presented here to this Court.

These Respondents contend that this case does not relate to a Federal question of substance; moreover, that the Maryland Court of Appeals correctly decided that question (that interest, as well as the principal amount of the tax itself, must be demanded to be paid — by the firm language of the tax Statute, as well as by long administrative practice — in order that the item of interest, in addition to becoming a *claim*, may also become a *lien*).

We contend also that the final decision below classicly turned upon State law — the nature of property rights or interests in property, and the effect of the recording statutes of Maryland — and hence apart from the correctness of the decision on the demand of interest point, basically involved state determinations of propositions governed by State law.

CONCERNING THE FACTS

The material facts involved in the decision below appears on Pages 14 through 17, and again on Pages 20 and 21, and finally, on Page 25 of the State Court Opinion, as reproduced at those pages in the Petitioner's Appendix B, and will not therefore be separately restated.

QUESTIONS PRESENTED

Of the Three Questions which the Petitioner propounds for consideration by this Court, he concedes that the Second was not expressly decided, and that the Third was expressly left open by the State Court. Yet, the Court of Appeals *quite clearly indicated a decision* on still another State law controlled point, i.e., the taking of possession, after default, of the mortgaged chattels, as the "*equivalent of recording*" of the mortgage, (Petitioner's App. B-26), which would render it unnecessary to pass upon any of the questions posed by the Petitioner. The State Court's determination on this "equivalent of recording" question, a conclusion pivoting solely upon State law, renders it unnecessary to consider Petitioner's Third Question at all and his contention thereon becomes altogether moot in this case. Furthermore, his Third Question continues to assume, as a fact, that the chattel mortgage is to be regarded as still unrecorded, notwithstanding the State Court's "equivalent of recording" observations — and despite its valid foreclosure.

Since, as the Appellate Court noted, (1) possession of the chattels is treated as the equivalent of recording, (2) the tax lien was admittedly not recorded until (a) after such recording equivalent had occurred and also (b) after public auction sale, for cash, to third party bona fide purchasers had been completed, (3) Bankruptcy did not occur until some sixteen months after *such recording equivalent and sale*, we contend either that Petitioner's Third Question has been disposed of on State grounds (equivalent of recording) or that it is otherwise unnecessary of answer here.

In that posture of the case Petitioner's First Question is entirely moot also and, disregarding the correctness of the

Court's decision on that point, an ineffectual subsidiary of the larger determination so finally made or indicated by the Appellate Court with respect to an issue alone controlled by State law.

Correctly stating the spheres of influence, as between Federal and State law, the Maryland Court of Appeals (Petitioner's App. B—19), soundly applying the controlling State law, determined, solely on State grounds, that all property and rights to property in the mortgaged chattels had, prior to the recording of the tax lien — which by Sec. 6322 of Title 26 of U.S.C.A. is required in order to give it any validity against a mortgagee or purchaser — been effectively passed from the chattel mortgagor to such purchasers and that the Trustee in Bankruptcy, who first came into being some sixteen months later, was not a lienor or encumbrancer within the meaning of the Maryland Statute on recording. This application of the Maryland law with regard to local property interests — and the determination of such property interests is exclusively the function of the State Court — disposed of the claim of the Trustee upon principles of State law.

Petitioner's application for a Writ in this case does not and cannot reach that proposition — turning, as it did, entirely upon Maryland law.

Mention should be made of the further fact that the State Court did not find it necessary in this case to rule upon another point involved in the case and argued by the parties to that Appeal. The Maryland Statute on recording (which we set forth in the Appendix to this Brief) is, as frequently is found to be the case in the various States, the product of long development, molded by numerous State decisions and legislative modifications. It

expressly makes unrecorded chattel mortgages *valid and enforceable* against all *except certain specifically designated classes*, including "subsequent purchasers, mortgagees, incumbrancers, landlords with liens, pledgees, receivers, and creditors who acquired a lien by judicial proceedings on such personal property". The Court below (Appendix B — 18 and 23) discussed this Statute and its coverage and consequences.

It was argued before the State Court, following State precedents, that even with regard to these designated classes, an unrecorded chattel mortgage was valid and enforceable unless *credit had been extended* by one of such classes in reliance upon possession of the chattel by the debtor.

Maryland decisions, describing the State's recording statutes as being intended to protect "trusting" creditors specifically dealing with such chattels (as, for example, a subsequent mortgagee, pledgee, purchaser), were pointed to as standing for the proposition that only such a trusting creditor was entitled to protection against a non-recorded chattel instrument, for only they could be said to have been harmed by the lack of recording, and since the Federal Tax claim was not that of such a trusting creditor — and the Trustee in Bankruptcy was not such a creditor — the Petitioner did not, in any event, bring himself within the purview of protection afforded by the Maryland law.

This point was not passed upon by the State Court, but a determination on that point would likewise render moot the contentions of the Petitioner in this case, since it is conceded also that, notwithstanding any other ruling, unless the Petitioner could bring himself within the protected classes contemplated by the State recording statute, he could not prevail on any ground.

We refer to these matters in order that this Court might have before it the full dimensions of this case, which do not appear from the Petition for the Writ submitted to the Court.

NO GROUNDS EXIST FOR THE GRANTING OF THE WRIT.

ARGUMENT

I.

THE MARYLAND COURT OF APPEALS CORRECTLY DECIDED THE ISSUE PRESENTED IN PETITIONER'S QUESTION NUMBER ONE.

The tax Statute (quoted on Page 11 of App. A by Petitioner) explicitly specifies that it is only after neglect or refusal to pay "after demand" that a tax lien arises, and when it does it applies only to the property and rights to property "belonging to such person". Not only is the mandate of that Section unmistakenly clear, but the factual testimony in the record below demonstrates that those charged by the Internal Revenue Service with tax collection procedures are familiar with such requirements and that a long continued administrative practice has been developed. The tax demand forms prepared by the Government for use in this connection also carefully provides a space for the amount of any interest which may be demanded. All of this is cogently analyzed and verified in the State Court's Opinion on Pages 20 and 21 of Petitioner's Appendix.

Petitioner cites no authority in support of his contention. He suggests that the taxpayer is charged with knowledge that interest runs from the date the tax is due; but this merely serves to concede that there may be a *tax claim*, separate and apart from a *tax lien*, as the Statute

directs the particular procedure by which alone a "tax lien" may arise. Even with regard to the amount of "taxes" (as distinguished from "interest" on such taxes), though the specific amount of such "taxes" be known to the taxpayer, a lien will not arise unless the amount is first demanded and payment thereof neglected or refused. In the absence of a demand, and it is here conceded that there was no demand for interest, a tax lien does not arise.

As a matter of fact, and this too is admitted, when the August 22, 1956 demand for payment of taxes was made in this case, upon which it is now claimed interest would accrue (even though not demanded), all of the taxes so demanded *had already been fully paid and no part of such taxes were then due.* The Tax Collector had acted in error, in making the demand for tax payment, since the very taxes then being demanded to be paid had in fact *already been paid*, and this error, acknowledged to have been made, is the act upon which the Trustee in Bankruptcy relies as the basis for his action in this case. The history and developments attending this matter are outlined in the Opinion of the State Court on Page 20 of the Petitioner's Appendix B. Had the Collector not been misled by his own office, it would appear, since the taxes had already been fully paid, that a demand would not have been made. The original action instituted by the Trustee, it may fairly be said, traces back to this original error of the tax Collector.

Included in the erroneous and mistaken demand, apart from the amount of taxes already fully paid, was a claim for a penalty for alleged late filing (which tardiness was disputed), an item which is of no consequence in this case, by concession of all the parties, since penalties do not become provable claims in bankruptcy (Petitioner's App. B — Page 21).

Question Number One, as submitted by Petitioner, turns upon a finding of fact by the Court; this appears in the Court's Opinion, with a complete analysis of the undisputed facts, at Pages 20 and 21 of Appendix "B", filed with the Petition in this case.

The Appellate Court collected and discussed in its Opinion the important cases (Pages 22 and 23 of Petitioner's App. B) which have considered the necessity for this statutory demand, in order that upon neglect or refusal "to pay the same after demand" a statutory Federal tax lien may be created.

II.

THE DOCTRINE OF "RELATION BACK" (PETITIONER'S QUESTION NUMBER TWO) HAS NO APPLICATION IN THIS CASE.

Evidently, this Question is depended upon by the Petitioner as justifying the issuance of the Writ, for he virtually concedes the correctness of the Lower Court's decision (on his Question Number One) respecting the necessity of a demand antecedent the creation of a tax lien, in the opening words of the second paragraph of Page 7 of his Petition.

The Petitioner then suggests that his "relation back" theory, under certain circumstances, overcomes the lack of prior demand. The plain wording, of course, of Section 6321 of the Internal Revenue Code requires that interest be demanded before "the amount" thereof shall become a lien. In support of this argument the Petitioner cites several cases, but it will be found that they are not pertinent to the Question presented here, nor applicable to the circumstances of this case.

In all of those cases the property sought to be affected was in the possession of the Trustee in Bankruptcy (Fidelity Tube Corporation), or in the possession of the Estate of the deceased taxpayer (U.S. v. Ettelson). In our case, the proofs of claim upon which the Petitioner depends as the basis for invoking his theory of "relation back" were first filed more than sixteen months after the property, sought to be subjected to the alleged lien, had been completely sold to bona fide purchasers, and many months after that sale had been finally ratified by the Court, whose officer sold such property.

The Petitioner, in framing his Question Number Two (Page 2 of his Petition) incorporates as "A." the further theory that the requirement of demand, written into the Tax Statute, may be waived by the taxpayer. No authority is cited to support this particular contention. The instant case, unlike those which are cited by the Petitioner in his discussion of his other theory of "relation back", to which his reference to a waiver by the taxpayer is coupled, did not involve merely the Tax Collector and the taxpayer, but the property rights of third persons, and it is not conceivable that an alleged, though unproven, act of waiver by the taxpayer could disturb or prejudice the property rights of third persons, whether they be bona fide mortgagees, bona fide purchasers or others, or for that matter supply the essential procedural step specified by Congress as a condition to the creation of a statutory tax lien.

The State Court has ruled that the foreclosure sale was validly made and that the sales were properly ratified, and therefore when the first of the alleged tax liens was filed, under prevailing State law, there was no property nor any right to property belonging to the taxpayer (Bankrupt). Neither *Fidelity Tube* nor *Ettelson* is authority for the proposition that a demand, first made at a time when the

taxpayer, under State law, no longer has any property interest, can be used to "relate back" so as to create a lien against an interest which was long before validly and effectively extinguished.

This contention, we submit, disregards the realities. It would permit the Petitioner to create, much later and long after the total disappearance of any property or interest in property in the taxpayer, a fictitious lien so as to seek to subject the chattels in the ownership of bona fide purchasers to a lien which had no existence when they became such purchasers, solely on a theory of "relation back". It is difficult to imagine a more frightening example of disregard of constitutional or orderly process.

The *Fidelity Tube* case (278 F. 2d 776) was marked by a very vigorous dissent by two Judges in that case, who pointed out that the majority decision, even under the circumstances of that case, not only disregarded the statutory prerequisite of a "neglect or refusal to pay", but also did violence to the pattern of priorities set forth in the Bankruptcy Act, and violated the long honored principle that the filing of a Petition in Bankruptcy operates as a cut-off date for the creation or perfection of liens (at Pages 788-91 of 278 F. 2d). The majority in this case, in which the property was still in the possession of the Trustee, relied primarily upon a single decision which had no relationship to Bankruptcy proceedings (Ettelson), while at the same time recognizing that other Federal Courts had reached contrary conclusions, even in Bankruptcy cases. See *In Re Crockett*, D.C. N.D. Cal., 1957, 150 F. Supp. 352, and *In Re Holdsworth*, D.C. N.J., 1953, 113 F. Supp. 878, both cited at 278 F. 2d 776, 780.

In the *Ettelson case*, 159 F. 2d 193 (7th C.A. — 1947), also cited by the Petitioner, the Government's demand definitely embraced, as a part of the combined amount,

the tax deficiency and the interest computed thereon; the supporting assessment list established that interest had been separately assessed (159 F. 2d at 195), and the demand (which, in the Ettelson case, consisted of the filing of the claim in Probate proceedings — while the property was still in the possession of the decedent's estate) referred specifically to the supporting assessment lists, indicating that a demand had been made for interest (159 F. 2d at 196).

The relation back theory of the Petitioner also disregards the statutory requirement that the demand must antedate the refusal to pay, as it disregards also the fact in this case, which is without dispute, that the demand for a "tax" payment here was first made when there were no "taxes" to be paid and consequently none which could be demanded to be paid. It ignores the administrative practice just as it rejects the purpose and format of U.S. Treasury Department Form 17, which is so fully discussed in the Opinion of the Court below (Petitioner's App. B — Page 20).

III.

THE RECORDING OF A FEDERAL TAX LIEN AFTER VALID FORECLOSURE OF THE CHATTELS DESCRIBED IN A PRIOR CHATTEL MORTGAGE DOES NOT SUBJECT SUCH CHATTELS TO THE SUBSEQUENT TAX LIEN, EVEN THOUGH THE CHATTEL MORTGAGE IS NOT FORMALLY RECORDED.

The Petitioner, in urging this Court to consider the issuance of a Writ, on the ground set forth as his third contention, overlooks many salient facts and also ignores the opinion of the State Court in this case.

This Question of the Petitioner suggests that the chattel mortgage must for all time be treated as unrecorded (it was recorded in one jurisdiction, which the Court below ruled was not the proper place for recording), even though

sixteen months or more before the Trustee in Bankruptcy came into being the chattels had been fully taken into possession by the mortgagee and even though they had been completely sold to bona fide purchasers at least sixteen months before the appearance of the Trustee in Bankruptcy.

Eminently noteworthy here must be the fact that this is really a collateral type of appearance, since, notwithstanding his knowledge of this case, the Federal Tax Collector does not advance any of the contentions submitted by the Trustee in Bankruptcy.

We have invited the Court's consideration to the pronouncement of the State Court that such act of possession by the mortgagee might be considered as equivalent to formal recording. Attributing to such possession the equivalence of such recording, and this is a matter for State determination alone, we find that while the tax lien was still unrecorded when the chattels were sold, the mortgage, in compliance with State requirements, had achieved a status equivalent to recording.

The tax lien contemplated by Section 6323 of Internal Revenue Code, is one which, upon filing of the tax lien, may subject "property and rights to property" belonging to the taxpayer. The State Court ruled that the sale at foreclosure, which antedated the filing of any tax lien, finally and effectively established that the taxpayer had no property or interest in property in such chattels. These are matters which are traditionally to be determined by State law. The highest Court of Maryland has ruled that there were no rights in property to which the tax lien could attach when the tax lien was filed, as the Statute required it must be, before it attained the status of a recorded tax lien in respect of purchasers or mortgagees.

The Federal tax lien Statute (Sec. 6321 of Title 26 of the United States Code, Annotated) limits its application, in cases in which a tax lien is actually created, to "property and rights to property, whether real or personal, belonging to such person", but it does not purport to fasten such a lien on property or the proceeds of property in respect of which there is no such property right held by the taxpayer. This Federal tax Statute does not create property rights; such rights are created or recognized only by State law. The State Court in this case ruled that under State law the taxpayer did not have any property or rights in property which could be subjected to a tax lien at the controlling date. See the Court's discussion at that portion of its Opinion appearing on Page 19 of Petitioner's App. B.

The decisions to which the State Court referred in its Opinion (Page 28 of App. B of the Petition herein) dealt, as we do here, with interpretations concerning State recording statutes, the purpose and meaning of which and the effect flowing from a failure to observe which are questions purely of State law — Collier, Vol. 4, Paragraph 70.79, p. 1618.

We do not deal in this case with a situation in which the argument is made that Sections 6321-23 of Internal Revenue Code might *subordinate* a State defined unrecorded mortgage to a valid general Federal tax lien, though subordination, of course, would require subordination only of so much as would be necessary to satisfy the amount of the tax lien (in the instant case, the Petitioner deals with a sum of approximately $13.00 of alleged interest lien, while the mortgage sale proceeds here exceed $148,000.00). Even so, "subordination" (which concerns itself with "priorities" only) would not render such a mortgage "fraudulent as against" or "voidable by" the Federal Government and bring about the situation commented

upon in the Opinion below (Page 18 of App. B.). Particularly, as the State statute does not permit unsecured creditors to challenge even an unrecorded chattel mortgage, would such an anomalous result do violence to the purpose of Maryland's recording statutes. Neither does the State recording statute, as construed by its courts, classify even an unrecorded chattel mortgage as "fraudulent" or "void" or "invalid"; it simply as an unrecorded instrument, must yield its priority to the extent necessary to allow payment of the other lien. See, *Plaza Corporation v. Alban Tractor*, 219 Md. 570 at 588 (cited below in that segment of its Opinion shown at Page 14 of Petitioner's App. B).

Even were this case one which involved a contest between an unrecorded but valid Federal tax lien and an unrecorded, though choate contractual chattel mortgage, we contend the latter would prevail. The Court's ruling in *United States v. R. F. Ball Construction Co.*, 355 U.S. 587, also referred to in the Opinion of the Appellate Court (Petitioner's App. B — Page 27), involved an assignment by a sub-contractor to a surety company, and not a contractual chattel mortgage, for a fixed sum, with full choateness, and was evidently treated by the majority as an inchoate instrument rather than as a contractual chattel mortgage. The dissenting Justices, considering that, despite the form was that of an assignment to a surety, it should be treated as if it were a chattel mortgage, and that as such a chattel mortgage, though unrecorded, it was superior to the Federal tax liens, even though the latter were recorded.

The instrument in this case is a true contractual chattel mortgage — it was fully choate and it has been held to have been a valid chattel mortgage under Maryland state law. (See, Opinion of State Court appearing at Page 23 of

Petitioner's App. B.). Moreover, the State Court, as we have noted, indicated that the mortgagee's possession, prior to the filing of the Federal tax lien, was equivalent to recording, and in that posture the instrument in our case may be regarded as a recorded chattel mortgage.

In *United States v. Ball*, the Tax Collector was directly asserting a lien against property which was then in existence, and which belonged to the taxpayer at the time of the filing of the Federal tax lien. None of these elements are present in this case.

The State Court referred (at that place in its Opinion which appears at Pages 27 and 28 of Petitioner's App. B) to some of the post-*Ball* cases, in which the conclusion was reached that a choate and contractual mortgage, even though unrecorded, prevailed against a Federal tax lien, even though recorded. The expressed purpose of the Federal Tax Statute was to enable the Collector to reach property "belonging" to the taxpayer but only such property. Where the bona fides of, and the existence of, a choate mortgage instrument coincided, the Collector does not prevail over the holder of that prior mortgage. The Alban mortgage was bona fide, was choate and long antedated the tax assessment (passing, for the moment, the clerical error which gave birth to the assessment and to the further fact that the Collector was not a "trusting" creditor). Perhaps, no legal or equitable principle is more honored in our jurisprudence than that which recognizes that "first in time is first in right".

CONCLUSION

The Petitioner, apart from the merits of the controversy, has failed to present any compelling reason why this Court should grant Certiorari in this case. There is no conflict in the Circuit Courts of Appeal. There is no Federal ques-

tion of substance. This case involves determinations of matters of fact peculiar to this case and the case below turned, basically, upon questions exclusively within the province of the State Court to decide. Beyond all this, the decision of the Appellate Court, even should Certiorari be issued, is sustainable on any remand by that Court exclusively upon State grounds. Additionally, there is the pointed indication, that under State law — which is controlling on this proposition — the chattel mortgage is to be treated as though it had been recorded, since possession of the chattels was taken prior to the filing of a Federal tax lien and that such possession is the equivalent, in Maryland, of recording.

For the reasons stated, it is respectfully submitted that no useful purpose can be served by granting the Writ of Certiorari in this case.

Status of Plaza Corporation

We do not know at this time whether the third Respondent, Plaza Corporation, will submit a Brief in this case, but it should perhaps be drawn to the attention of this Court, as a factor which was noted by the State Court (and by the Trial Court) that Plaza's interests in this case, though it is designated herein as a Respondent, would prompt it to support the contentions of the Petitioner for the Writ in this case (App. B., page 18, footnote).

Respectfully submitted,

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Nathan Patz,

Attorneys for the two
named Respondents.

APPENDIX

Annotated Code of Maryland (1957 Edition):

Article 21, Section 41 (as amended in 1949):

"No personal property, of any description whatever, whereof the vendor, mortgagor, or donor shall remain in possession, shall pass, alter or change, or any property therein be transferred to any purchaser, mortgagee or donee, *as against subsequent* (1) *purchasers*, (2) *mortgagees*, (3) *incumbrancers*, (4) *landlords with liens*, (5) *pledgees*, (6) *receivers*, *and* (7) *creditors who acquired a lien by judicial proceedings on such personal property*, unless by bill of sale or mortgage acknowledged and recorded as herein provided; but nothing herein shall be construed to extend to and sale or gift, where the same is accompanied by delivery, nor gift, where the same is accompanied by delivery, nor to invalidate such transfer as between the parties thereto." (Italicized portion added by 1949 amendment, numbers inserted for convenience).